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Testimony before the New York State Department for Environmental Conservation

December 14, 2006

Thank you ________________ for allowing me to speak today.

My name is Andrew Kruger, and I am Vice President for Greenhouse Gas Markets at Evolution Markets, the largest global greenhouse gas brokerage. We regularly receive industry accolades; as recently as yesterday in fact, we were named in *Environmental Finance* Magazine's survey as Best North American Greenhouse Gas Broker, Best EU Emissions Trading Scheme Broker, and, once again, Best Broker in the US SO_2 market, which is of course the first emissions cap and trade program and the largest in the US. We are based in White Plains, NY and have served as an advisor to Governor Pataki's Greenhouse Gas Working Group.

My firm and I have been involved in every emissions market. I have nearly 20 years experience in emissions trading. I began my career as a regulator at US EPA Headquarters in Washington, DC, and worked at AER*X, the nation's first emissions brokerage. I was involved with the development and deployment of the US SO2 cap and trade program, as well as both generations of the NOx budget program.

I am here on my own behalf today to express my concern about the 100% auctioning proposal presented by NY State as part of its proposed rule to implement a greenhouse gas emissions trading program. The NY program as proposed will in fact not be a true trading program at all, it will be a tax. Please allow me to explain.

There is a reason that every existing cap and trade program has had an allocation process that has distributed allowances. That is, without the equitable distribution of allowances, every ton will have a cost. This is economically inefficient since this cost will not be tied to the cost of emissions reductions or any baseline. This means that any reductions beyond those that are mandated will not be rewarded financially and thus are unlikely. To repeat, there will be no incentive to overcomply in a fully auctioned program.

There were similar allocation concerns during the development of the US SO_2 program. Consequently, Congress incorporated an annual auction of approximately 2.5% of the total allowance budget. Once the market began however, it became clear that auctioning in the US SO_2 market hindered market development rather than supported it. Moreover, time and again in the SO_2 program we have seen expectation-led price distortions in the run-up to and aftermath of the SO_2 auctions. These distortions have served no beneficial purpose in the market.

In addition, the money from New York’s proposed 100% auction would not flow to the regulated industry. Instead, all monies, potentially hundreds of millions of dollars, would flow to a state fund. This amounts to a tax. In other cap and trade regimes such as the SO_2 and NOx programs, and the European Union’s Emissions Trading Scheme, monies from the purchase and sale of allowances are used to fund equipment installations, for example , thus providing incentive to make further emissions reductions. Is there an existing group within the state prepared to beneficially distribute the expected millions of dollars?

A 100% auction leaves no initial tons in the hands of incumbents. A program ostensibly based upon a tradable commodity ironically finds the commodity completely missing. Consequently, options to seek efficiency through trading are missing. That is not a cap and trade program. Under this proposal industry is not incentivized to find new and innovative emissions reductions at their own plants. Rather they will struggle to conform through expenditures to buy allowances.

The choice, as presently proposed by New York, is to pay a tax, or control with no incentive to “over-control” emissions. There is no interplay between the two dynamics and thus little incentive for increasing efficiency. There is by extension no increasing benefit to the environment and consumers and industry will likely have to pay more for their power.

As currently proposed, the best we can hope for is compliance with the cap, not efficiently exceeding environmental goals; and millions of dollars sitting with the New York state treasury, instead of being further invested in control technology.

That is why I am concerned, and why I am here today pleading for the allowances to be put into industry circulation as has been done in every other emissions trading program.

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